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Independent Review of the Postal Services
Sector
Department for Business Enterprise and
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Date:– 27 March 2008
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Dear Richard,

First Submission to the Review Panel by the Independent Regulator:

I am enclosing the first set of evidence which Postcomm would like to have considered by your Review Panel. Given the requirement for transparency in all that we do, we are placing the submission and this covering letter into the public domain.

Our evidence demonstrates why your Review Panel's work is of such critical importance. Royal Mail is one of the largest employers in the UK and it provides a service which is used every working day by practically every member of the adult population. However, it is our belief that Royal Mail's current business model is unsustainable. Our submission to the Panel argues that, unless some bold actions are taken very quickly, it is very likely that the addressed letters business will move to a position of managed - but accelerating - decline. This outcome will be highly detrimental to all mail users and extremely costly for the taxpayer.

1. What is the core of the problem?

Postcomm's pessimistic assessment reflects the limited progress that Royal Mail has been able to make towards becoming a more efficient and customer-focused operator and, in particular, the limitations of its response to the significant structural changes in the mail market, triggered by the rapid emergence of digital communications media. However, there is no inevitability to this scenario of a shrinking and unprofitable Royal Mail addressed letters and packets business.

Royal Mail's actions suggest to us, and to many of its stakeholders, that the Company has been more pre-occupied over the past two years in confronting the new mail competition than it has been in addressing the much bigger threat of these structural changes in the market. A much bolder set of initiatives are now required to transform the business and to secure a vibrant Royal Mail.

We will discuss these initiatives in our second submission of evidence to be made in May 2008.

2. The impact of liberalisation

All mail users have seen some benefits (albeit to varying degrees) from market opening and also from our regulatory incentives. These initiatives have prompted Royal Mail to improve significantly its quality of service and to push for greater efficiency. Competition has also offered to business mailers benefits which have kept their mail usage higher than it would otherwise be, and have kept their costs down (thus increasing their overall competitiveness).

Access operators have, indeed, taken nearly 10% of upstream mail volumes from Royal Mail and a further 10% has migrated to upstream carriers as a result of Royal Mail's own initiatives. But our evidence to the Review Panel demonstrates that that this has happened because competition in this part of the market is beginning to work. These Access operators are considerably more cost efficient than Royal Mail, are offering the customers innovative products and a better customer interface and are paying a fair price to Royal Mail for their work in delivering over the final mile

Many of the constraints facing Royal Mail would, in any event, come from the application of general competition law even in the absence of Postcomm's regulatory initiatives. Regulation continues to be necessary given Royal Mail's market dominance (they still handle well over 95% of all letters over the final mile) The amount of competition that has developed is modest, with end-to-end volumes of Royal Mail's rivals still tiny and now below those of two years ago.

3. The future of the mails market

Our evidence considers carefully whether mail is doomed in the digital world, just as canals were after railways were built. The answer - for which we can draw usefully on international experience - unequivocally, is that this does not have to be the case. But it is Royal Mail's actions over the next few years which will shape the development of the mail market in the UK, because there is no prospect of them being anything less than the dominant player.

Addressed letter volumes have declined over the past two years but this, to a large degree, reflects the higher prices that Royal Mail have had to charge to recover their inefficiencies and the massive pension cost burden. Mail has characteristics which can make it even more valuable in the digital world, such as its personal nature and the capability to deliver each day to every one of the 28million addresses in the UK; a highly important differentiating feature in the e-commerce world.

But to succeed against growing digital competition, mail has to become more price competitive and the product range has to be significantly reshaped so that it is complementary to – rather than competitive with – digital media. This is why we regard it as an imperative that there be a radical transformation of the Royal Mail business which surpasses significantly the not inconsiderable achievements that the new management team have made over the last four years.

Although the rewards from successful transformation of Royal Mail's core mails business are substantial, there are some significant risks to the successful

implementation and for these to be manageable there needs to be absolute focus and the entire workforce has to be appropriately incentivised.

Regulation can and should be reduced when there are no substantial barriers to entry and competition has become firmly established; a level playing field on VAT is important in this context.

4. Next steps

This submission covers your supplementary questions. However, we have gone beyond these where it is necessary to give a fuller picture of what the present situation is. For ease of reference, I attach a summary of our responses to these questions and references where these are covered in our submission.

We have tried to keep this submission as brief as possible but the issues we need to cover are extremely complex ones. We hope, therefore, that the Panel will allow us the possibility of making a further submission before you finalise in late April your report of the first two headings of your terms of reference, should other points be raised which we have not covered in sufficient depth.

Postcomm's vision has always been one where a successful Royal Mail can deliver a universal service which, in both quality and scope, is fully capable of meeting the changing needs of mail users without a subsidy and alongside the development of effective competition and choice. Many of the essential building blocks for the achievement of that vision have been put in place over the last several years. However, the most important one of all - namely the effectiveness of Royal Mail's response to addressed letters competition, regulation, and the structural changes in the mail market - is shaping up very differently to how we, and many other stakeholders, had hoped and expected.

My fellow Commissioners and I look forward to the opportunity of discussing our views with Panel members. We hope the Secretariat will contact us if there is further information that usefully we can provide to the Panel.

Yours sincerely



NIGEL STAPLETON
Chairman